

Document inspection rights for shareholders of private companies

The rights of shareholders of privately held corporations or members of limited liability companies, or LLCs, to inspect and copy the corporate documents is a hot topic in the venture capital sphere. This article answers some fundamental questions about the topic so as to identify the most important legal points under Delaware law.

Do shareholders have inspection rights? If so, why?

There are two sources of inspection rights. Shareholders almost always have statutory inspection rights under Delaware law. Shareholders may have contractual inspection rights under the terms of the operating agreement (for an LLC) or another agreement such as an investment agreement or the by-laws. Shareholders may demand to inspect documents on both grounds if a contractual source of rights exists.

How do statutory and contractual inspection rights differ?

Generally, Delaware statutes set explicit rules governing a shareholder inspection demand, while an LLC operating agreement or other contract may set forth those rules or instead create new rules. Here are the basic similarities and differences:

	Statutory right	Contractual right
Basic source of right to inspect	What the (Delaware) statutes say	What the contract says
How shareholder makes inspection demand	Follow the formal steps listed in the statutes	What the contract says; tends to be less formal
Process to respond to demand or potentially object to inspection	Corporation must respond within five days, after which shareholder can file inspection demand claim in Delaware	If shareholder does not like corporation's response, can file breach of contract claim
Whose documents may the shareholder inspect?	S corporation or LLC and its subsidiaries; maybe some affiliates	Usually only the corporation or LLC (that's the only entity the contract governs)
Does the shareholder have to state a proper purpose for inspection?	Yes and if challenged, shareholder must provide at least some supporting evidence before getting to inspect documents	No, but corporate manager may defeat right to inspect if it proves that allowing inspection would hurt the corporation
General documents that may be inspected	Stock ledger and shareholder list (S corporation), tax returns (LLC), "books and records"	The documents listed in the contract (although "books and records" is often used)
How does the court decide what documents the shareholder gets to inspect?	Judge (in expedited proceeding) asks whether shareholder has shown need for each particular type of document it demands	Judge (in normal civil lawsuit) conducts detailed analysis of the contract
Confidentiality	Statutes allow corporation to require shareholder to keep documents confidential	Almost certainly fiduciary right to require shareholder to keep documents confidential

Does loser pay winner's attorneys fees?	Court may award fees to prevailing party	Only if such a provision is in the contract
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Can an LLC operating agreement or other agreement provide greater or lesser inspection rights than allowed under the statute?

Yes. The agreement may specify that shareholders (or some of them) have the right to inspect types of documents that may not be covered by the statute. It's an open question whether a contract can eliminate statutory rights.

When a proper purpose for inspection is required, what does that mean?

Courts take a broad view. Most notably, investigating potential mismanagement (including for purpose of deciding whether to sue the officers and directors) is a proper purpose. So is trying to value one's shares in the corporation or communicating with other shareholders. What's not proper is to seek corporate documents in order to advance a personal grievance that does not arise out of the shareholder relationship, such as an employment or breach of contract dispute.

What are "books and records"?

It's not defined in the statutes, but basically it's the set of documents that are essential and sufficient for the shareholder to have in order to fulfill its purpose for inspection. Depending on the purpose, courts have ordered inspection of Board and Board committee minutes and packages; new director questionnaires; officers' e-mails regarding the topic at issue (if kept on the corporation's e-mail system), and document retention policies.

Can the shareholder inspect attorney-client privileged documents?

No, unless the shareholder can show that good cause exists because the documents are necessary and essential for the claim.

If the corporation rejects an inspection demand and goes to court, how do Delaware judges view inspection rights?

Anyone who thinks that Delaware courts always favor corporate managers over rank-and-file shareholders hasn't looked at inspection cases. The courts strongly support inspection rights. Indeed, courts chastised plaintiffs' lawyers for years to not making statutory inspection demands before bringing shareholder derivative lawsuits, and courts favor enforcement of contracts. Where a dispute goes to court, in general, judges completely reject a demand only where it is based solely on the statute and the demanding shareholder either doesn't provide enough evidence that its purpose for inspection (such as investigating mismanagement) is real or didn't follow the statutory formalities. Judges also cut back demands that are too broad and look like fishing expeditions.

So if completely rejecting a demand is likely to lose, what should the corporation do?



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Many inspection demands never get to court because the parties compromise. The corporation should consult with counsel, assess how a court would regard the demand, and try to identify and produce a set of documents that is not too burdensome to produce and reflects the courts' basic support for inspection rights, unless there is a reason to think that producing documents to the particular shareholder would hurt the corporation.

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